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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967.

No. 104

ALEXANDER TCHEREPNIN, et al.,
Petitioners,

vs.

JOSEPH E. KNIGHT, et al.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR ALEXANDER TCHEREPNIN, ET AL.

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OPINIONS BELOW

The opinion of the United States District Court has not been reported and is printed in the Transcript of Record herein at pages 29-33.[1] The majority and dissenting opinions of the United States Court of Appeals for the Seventh Circuit are reported in 371 F. 2d 374, and are printed of record herein at pages 43 and 53 respectively.

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1. References to the Transcript of Record are hereinafter designated (R. ....).

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on January 20, 1967. The petition for a writ of certiorari was filed April 20, 1967, and was granted on June 5, 1967. The jurisdiction of this Court rests on 28 U. S. C. 1254(1).

QUESTIONS PRESENTED

1. Is a withdrawable capital share issued by a state-chartered savings and loan association "stock," a "transferable share," an "investment contract," a "certificate of interest or participation in a profit-sharing agreement," or otherwise within the definition of "security" contained in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U. S. C. 78c(a)(10)?

2. Are withdrawable transferable shares in a mutual savings and loan association, which represent its only capital and entitle holders, who are not involved in the association's management, to participate in its net profits (or losses), securities within that definition, so that the anti-fraud provisions of that Act are applicable to purchases and sales of such shares?[2]

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2. The complaint alleges that the sales of the shares here were on a restricted basis as to withdrawability (R. 13, 14). Obviously, the questions here presented as to withdrawable shares encompass the subsidiary question whether shares restricted against withdrawability are securities, and such question is comprised in the questions presented. See Rule 23(1)(c) of this Court. Sections 3(a)(13) and (14) of the Securities Exchange Act of 1934 (15 U. S. C. §§ 78c(a)(13) and (14) are involved in that subsidiary question.

STATUTE INVOLVED

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U. S. C. 78c(a)(10) provides:

3. (a) When used in this title, unless the context otherwise requires—

* * * * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

STATEMENT

1. The Nature of the Action and Parties Thereto.

This is an action pursuant to Sections 10(b) and 29(b) of the Securities Exchange Act of 1934 (15 U. S. C. §§ 78j(b) and 78cc(b)) and Rule 10b-5 promulgated thereunder (17 C. F. R. 240, 10b-5). Respondents here and defendants-appellants below are City Savings Association (hereinafter "CSA"), its officers, directors, "liquidators" and certain officials of the State of Illinois who had seized custody of CSA at the time the Complaint herein was filed. It is brought by approximately 150 investors in the capital shares of CSA, on their own behalf and as a class action on behalf of over 5000 investors who purchased such shares between July 24, 1959 and June 26, 1964 (R. 2-5, 12). They seek to rescind the purchases and to recover the purchase prices paid for the shares of CSA allegedly fraudulently sold, as hereinafter set forth, to them (R. 6, 13, 14).

CSA is a savings and loan association chartered as a corporation under the Illinois Savings and Loan Act (hereinafter "the Illinois Act") (Ill. Rev. Stats., 1963, ch. 32 §§ 701-944).[3] By §§ 706 and 708 of the Illinois Act, CSA was granted all general powers of a business corporation under the Illinois Business Corporation Act (Ill. Rev. Stats., 1963, ch. 32 §§ 157.1-157.167) and was permitted to carry on the business of a savings and loan association for its stockholders.

3. References in this Brief by section number, without other identification, are to the Illinois Act.

2. CSA's Statutory Power to Raise Capital by the Sale of Withdrawable Capital Shares and Accounts.

All of CSA's capital under the Illinois Act consisted of "withdrawable capital accounts (shares and share accounts)" (§ 761(a)).[4] CSA solicited the purchase of such shares and share accounts by means of flamboyant sales literature sent through the United States mails to petitioners and others residing throughout the United States (R. 5, 9). As inducements, CSA offered expensive merchandise premiums and represented that CSA was of financial strength and that its securities were a desirable purchase (R. 9, 10).

Under the Illinois Act, CSA could accept payment for its shares and share accounts according to the following described plans.[5]

1. (Regular installment plan): CSA was empowered to enter into a subscription agreement with a purchaser under which the purchaser would agree to make weekly or monthly installment payments until

4. By § 761 it is made clear that when the term "withdrawable capital account" is used in the Illinois Act, it refers to "shares and share accounts". Thus, wherever the word account is used in the Illinois Act, it means "shares and share accounts". § 761 also permits capital to be secured by the sale of permanent reserve shares, but those are not here involved since CSA never sold any nor does the Complaint relate to same.

5. Exhibit A to the Peat, Marwick, Mitchell & Co. Special Report, hereinafter identified as part of the record in footnote 9, page 10, indicated that as of April 30, 1964, shortly before CSA was seized by the Department of Financial Institutions of the State of Illinois, its withdrawable capital consisted of the following:

Dues Paid on Installment Plan Shares	$ 52,722.
Optional Plan Shares	$ 540,070.
Pre-paid Shares	$ 3,552,500.
Paid-up Shares	$ 1,435,342.
Investment Shares	$21,914,992.
Christmas Club Shares	$ 16,484.

the total amount paid plus dividend credits reached the value agreed upon in the subscription, referred to in the Illinois Act as the "maturity value"[6] (§ 762(d)(1)).

2. (Full paid plan): A purchaser could make one single payment of $100 per unit; thereafter, dividends when and if declared and credited would be payable in cash unless by agreement they were to be retained in the account (§ 762(d)(2)).
3. (Pre-paid plan): The purchaser could make one single payment in such amount per $100 unit as the By-Laws set forth; thereafter the share account would increase to an ultimate or "maturity value" of $100 per unit through the Association crediting declared dividends to the account (§ 762(d)(3)).
4. (Optional Plan): The purchaser could make payments of such amounts and at such times as he elected; under this plan dividends would be credited to a holder's account unless by agreement between the holder and CSA they were made payable in cash. (§ 762(d)(4)).
5. (Bonus plan for purposes of thrift and long term investment):
   a) The purchaser could make an agreement to make regular payments, at least monthly, of any predetermined amount, until the payment together with dividends apportioned thereto equaled two hundred times the agreed monthly payments. If the agreement were kept, the purchaser would receive a bonus (§ 781(a)).
   b) (Long term plan): The purchaser could subscribe to an agreement that he would maintain an agreed balance in his account for a period of 4 or 8 years. In the event the agreement were kept, he would receive a bonus at the agreed rate (§ 781(b)).

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6. § 774(a).

3. Withdrawability and Maturity re Capital Shares and Share Accounts.

Under the Illinois Act, holders of withdrawable capital may make application for withdrawal of, and the association may, even if it has sufficient funds on hand, either pay or refuse to honor such application (§ 773(a)). Further, the association may wait for a period of 30 days within which to determine whether it has such funds before paying any applications (§ 773(b)). Thereafter, if refusal to pay is because there are insufficient funds in the treasury and from current receipts to pay all matured accounts and applications for withdrawal within 30 days after such accounts mature or withdrawal is applied for, the Board of Directors is required under the Illinois Act to establish a rotation procedure for payments (§ 773(b)). The holder of withdrawable capital for which application for withdrawal has been made does not become a creditor by reason of such application (§ 773(f)).[7]

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7. To understand the nature of the savings and loan business and the reason why withdrawable shares must of necessity be only conditionally withdrawable, it is necessary to comprehend the structure of the entire industry. As pointed out heretofore in the Reply of Petitioners to Briefs in Opposition to the Petition for Certiorari, pp. 9-10:

> "The legislatures in all states and the Congress have carefully constructed a form of business enterprise where the debtor-creditor relationship would not exist between an association and the investors in its capital. Such capital investments generally are designedly called 'shares', 'capital accounts', and by other terms of recognized meaning which cannot be confused with banking usage.
>
> "To understand the reason for this structuring of the entire industry, it is necessary to compare the long-term mortgage lending function of savings and loan associations with the commercial banking functions of banks, historically and at present. Because banks are subject to demand withdrawals by depositors, and have a debtor-creditor relationship with them, by necessity they have avoided freezing any substantial part of their deposits into long-term real estate mortgage loans. On December 31, 1965, of the total of almost $378.9 billion of

When purchases under plan "1" reached the agreed value, and under plan "3" the value of $100 per share, CSA was empowered either to pay the holder this "maturity value" of his shares directly,[8] or to notify the shareholder that he was entitled to receive payment under the agreement or to transfer his account into other withdrawable capital (§ 774(a)). If CSA followed the notification course, then if within sixty days after the date the notice was mailed the shareholder had taken no action, the Illinois Act empowered the directors of CSA to convert the shares at their "maturity value" either into other withdrawable capital or into a so-called "creditor account" (§ 774(a)).

Except as provided otherwise in the contract between the shareholder and CSA, such capital accounts were withdrawable before reaching the agreed "maturity value" (§ 762(a)), subject to the same conditions as all other withdrawable capital purchased under other plans (§ 773, see p. 7, *supra*) and not including any portion of the "bonus reserve" (§ 781) which may have been retained

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assets of commercial banks in the United States, only 13.1% was invested in such loans. (Rep. of Call 74, Dec. 31, 1965, FDIC, Washington, D. C., p. 2.)

"Savings and loan associations on the other hand were created and have multiplied to fill the gap thus left in the national economy. They accumulate capital by selling their shares across the country, and gather together the invested monies of their shareholders for the express purpose of providing funds to satisfy the need for long-term real estate mortgage loans, in their own jurisdictions and in other states. The investments are designated as shares of capital, under one term or another, because that is characteristic of the relationship desired and created by the investment contract. In virtually every jurisdiction, the investment is subject to withdrawal from time to time, if, and only if, the associations have funds available in excess of their currently owing cash commitments for the purpose for which they were founded. On December 31, 1965, of the total of almost $129.5 billion of assets of savings and loan associations in the United States, 85% was invested in such mortgages. (An. Rep. Dec. 31, 1965, Fed. Home Loan Bank Board, Washington, D. C., p. 133.)

8. Payment would be subject to the conditions of § 773.

or of the dividends which, pursuant to the By-Laws, had not been credited directly to the account but had been credited to "[un]divided profits" of the Association (§§ 710(t), 778(d)).

4. Management of CSA's Affairs and Rights of Shareholders.

Every capital account, however purchased, was required by the Illinois Act to be evidenced by one or more appropriate certificates, and either such certificates or an account book or both were required to be delivered to the holder of the shares or share account (§ 768(a)). These shares and share accounts were personal property in the hands of the holders (§ 761) and were expressly made transferable by written assignment accompanied by delivery (§ 768(b)).

Under the Illinois Act, CSA's business and affairs were to be managed by its board of directors (§ 744(f)), which elected its officers (§ 746(a)). The board of directors was elected annually for one year terms (§ 744(b)) by vote of the persons holding capital shares or share accounts and by borrowers; the Illinois Act gave persons holding such shares or share accounts the vote of one share for each $100 and for any fraction of $100 of the aggregate withdrawal value of their accounts (§ 742(d)(2)), and gave each borrower one vote in addition to any vote he may otherwise have had (§ 742(d)(4)). The provisions for voting either in person or by proxy (§§ 742(c), 744(b)) were identical with those in the Illinois Business Corporation Act (Ill. Rev. Stat., Ch. 32, § 157.28 (1963)). Shareholders could attend annual meetings (§ 743), and in addition to voting for directors could pass on organic changes, such as amendments of the articles of incorporation (§ 812), mergers (§ 816), sales of all or substantially all assets (§ 821), reorganizations (§ 872) and voluntary liquida-

tions (§ 902); upon dissolution or liquidation they would receive their prorata share of the property of the Association after payment of its debts (§§ 908, 926). The shareholder's capacity to acquire the information necessary to solicit proxies effectively or to cast his vote knowledgeably as to these matters, however, was limited by the statutory restriction on his access to the books and records of CSA. A shareholder had the right to inspect only such books and records of the association as pertained to his account (§ 748).

Investments.

The management of CSA could borrow money for the use of the Association (§ 707). It could invest CSA's capital in loans on the security of its own shares or of real estate virtually without restriction, no limitations being set in the Illinois Act as to the kind or speculative nature of improvements to be financed by the loans (§ 791).[9]

9. The record here discloses the nature and type of the ventures in which CSA's directors invested the capital committed to them by the shareholders. It also demonstrates the reason for CSA's insolvency. These disclosures are contained in the Peat, Marwick, Mitchell & Co. Special Report (hereinafter "The Report"), which is part of the Record here, a summary of same being printed in the transcript (R. 40-42). That Report, prepared for the Department of Financial Institutions of the State of Illinois and submitted to its Director, respondent Knight, on June 15, 1964, purported to reflect CSA's financial position as of April 30, 1964. Within eleven days after receipt of this Report, CSA was seized by respondent Knight under the authority of § 848 of the Illinois Act.

The Report reveals the following:

1. $31,475,499.00 of CSA's total assets of $34,486,264.00 were invested in first mortgage loans (Ex. A to The Report).

2. $25,814,435.00, or 82% of CSA's total portfolio of such loans went to the development of two real estate subdivisions known as Apple Orchard, Bartlett, Illinois, and Howie in the Hills, Hoffman Estates, Illinois (R. 41; The Report, p. 5). The funds made available for this purpose by CSA were for land purchases, subdividing, development of land, and construction of buildings (The Report, p. 8). Since the time these developments had been started, CSA financed and refinanced the same properties to the extent of

Under certain conditions (§ 792), the management could invest more than 45% of the Association's total assets as follows: certain marketable investment securities (15%) (§ 792.8), the initial purchase and development of residential properties (10%) (§ 792.7), direct general obligations of certain political subdivisions (15%) (§ 792.6), obligations of urban renewal investment corporations (5%) (§ 792.10) and other investments (§§ 792.1-792.5, 792.9).

Dividends.

Share and share account holders were entitled to dividends when and if declared (§ 762(b)) through which they participated in the profits of the Association (§§ 778, 779, 780). CSA was required to apportion profits and losses at least annually and was empowered to declare dividends out of profits after each apportionment (§§ 778(c), 780),

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$64,250,000.00 (R. 42). The intimate connection and financial interest of present and past officers and directors of CSA with the promotion and construction of these developments is shown in Schedule 2 and Appendix C to the Report.

3. Included in loans to these two developments were the sums of $959,336.00 and $806,790.00 for two golf courses, $241,674.00 for farm and riding stables, $1,958,522.00 for a country club subdivision, and $5,267,174.00 for a shopping center (The Report, pp. 6, 7).

4. The book value of the loans in connection with these two developments exceeded current test appraisals of the properties involved by $14,110,711.00, thus impairing CSA's assets to that extent, at least (The Report, pp. 4, 11).

Under these circumstances it is difficult to explain why supposedly responsible officials of the Department of Financial Institutions of the State of Illinois, within a month after seizure of that institution by them, approved a plan of purportedly voluntary liquidation purportedly voted by the shareholders on July 28, 1964 (R. 44), particularly since custody of a seized savings and loan institution is to be relinquished only where the Director finds that the causes for taking custody have been removed (§854). Absent such finding, which could not occur here because of the magnitude of the impairment of CSA's capital, it was mandatory that a receiver be appointed by defendant Knight and that on his initiative the liquidation proceed only under court supervision (§§ 921-923).

5. The Amended Complaint Alleges Material Frauds.

Material Adverse Information Concerning CSA's Dominant Director and Principal Executive Officer Was Concealed.

At all relevant times, the board of directors of CSA, its policies and activities were dominated and controlled by defendant C. Oran Mensik. From about 1943 until filing of this action, Mensik was CSA's principal executive officer (R. 6).

Beginning in 1957, Mensik became the subject of a substantial flow of adverse publicity in which he was accused, among many other things, of certain specified misconduct as a director and officer of CSA in breach of his fiduciary duties, and of mismanagement (R. 6-8). In 1959, he was indicted in the U. S. District Court in Maryland on mail fraud charges involving savings and loan associations, and was ultimately convicted (R. 8).

Because Mensik's name, thereafter, was not likely to engender trust and confidence in the minds of prospective CSA shareholders, Mensik and the other directors and officers of CSA in 1959 and continuously thereafter conspired to and did conceal from the investing public, including petitioners, that Mensik was in any way connected with CSA as a director or officer. Such concealment constituted the omission of material facts, the disclosure of which would have caused investors to refrain from investing in the shares which CSA was constantly issuing (R. 8, 9).

CSA's Financial Strength Was Misrepresented.

CSA solicited investments in its shares by sales literature mailed to investors in many states of the United States. That literature spoke of the financial strength of CSA and advanced reasons as to the desirability of investing in its shares. However, because CSA's financial

policies and management were found to be unsafe, the Federal Home Loan Bank Board had rejected CSA's application for insurance of its shareholders' accounts, thus refusing the insurance customarily provided by that Agency to shareholders of both federal and state chartered savings and loan associations, leaving such accounts uninsured. CSA's sales literature did not disclose such rejection, the reason therefor, or any of such facts. Included in such mail solicitation, among others, were investors in federally insured savings and loan associations, who in reliance upon such solicitations liquidated such investments and reinvested in CSA shares, thereupon becoming uninsured because of the above-stated non-disclosures (R. 9, 10).

CSA Concealed the Withdrawal Restrictions It Had Imposed Because of Its Financial Difficulties.

Beginning in 1957, CSA was in difficulties because its cash commitments far exceeded its cash resources, and it therefore imposed restrictions on withdrawals by investors. A 1959 amendment to the Illinois Act, under such circumstances permitted sales of new investments but prohibited CSA from placing withdrawal restrictions thereon. Nevertheless, after July 23, 1959, CSA contracted to sell restricted withdrawal shares to investors, including petitioners, without disclosing to them that such sales were unlawful, that CSA was on a restricted withdrawal basis, or that it had financial difficulties requiring such restrictions (R. 10, 11).

6. Respondents' Motions to Dismiss.

Insofar as here pertinent, respondents moved to dismiss the Complaint on the ground that Section 10(b) of the 1934 Act does not apply to fraudulent sales of withdrawable capital shares of savings and loan associations (R. 15-17).

7. The District Court Sustained the Complaint and Was Reversed Below.

The District Court denied respondents' motions and held that petitioners had entered into "an investment contract and in effect are purchasers of securities within the meaning and provisions of the Exchange Act" (R. 17, 32). It certified its order for interlocutory appeal, pursuant to 28 U. S. C. § 1292(b) (R. 32). The United States Court of Appeals for the 7th Circuit reversed this order in a 2-1 decision, Judge Cummings dissenting.

SUMMARY OF ARGUMENT

This Court has established that the definitions of a security set forth in Section 3(a)(10) of the Securities Exchange Act of 1934 are designed to cover the many schemes devised by those who seek the use of other people's money by promises of profit. Accordingly, this Court has held that the question as to whether or not a particular interest is a security is to be decided flexibly rather than on narrow principles and always with a view towards whether or not such interests either on their face answer the description of a security or are dealt in under terms and courses of dealings which establish them as such.

The application of these principles to the capital shares and share accounts sold by an Illinois savings and loan association requires a determination that such interests are securities within the purview of the 1934 Act because of their basic and material characteristics and attributes under the Illinois Savings and Loan Act. Such characteristics and attributes include those which relate to the risk of investment taken by the purchasers of such interests and to their rights to participate in the selection of management and to share in the profits, if any, by way of dividends. Those characteristics stamp the interest here as "stock", "transferable share", "certificate of interest in a profit-sharing agreement" and "investment contract".

These interests also fall within the catch-all clause of the definition, "commonly known as a 'security' ", because the substance of the investment relationship of the interests here involved is that of investments commonly known as a "security", and because of the following additional reasons:

1. The State of Illinois and other States have many times specifically referred to these interests as "securities" in a number of statutes covering legal investments. In addition the Illinois Securities Act itself speaks of these as "securities".

2. The savings and loan industry recognizes these to be "securities" and has so recognized them even prior to passage of the Securities Act of 1933.

3. The federal agency in charge of administration of the Securities Exchange Act of 1934 has consistently regarded these interests as "securities" from 1934 to the present time.

The Court below, in deciding that capital shares and capital accounts of Illinois savings and loan associations were not securities within the definition of the 1934 Act, failed to heed the *caveats* of this Court as to the liberal construction to be given definitions in such remedial Acts. It ignored all the basic and material characteristics which established these interests as securities, apart from brief passing reference thereto, and accorded them no weight whatsoever. Instead, it preoccupied itself with and relied on relationships which do not exist under the Illinois Act between the owner of a capital share or share account of an Illinois savings and loan association and the association, and also on characteristics which were entirely immaterial to the question before it. Thus, among other erroneous findings, the Court below held the transactions here under scrutiny to be loans repayable at interest at the will of the lender, despite the plain provisions of the Illinois Act and the decision of the Illinois Supreme Court that such debtor-creditor relationship is neither permitted by the Illinois Act nor otherwise legal.

ARGUMENT[10]

I.

Withdrawable Capital Shares in a Savings and Loan Association Are "Securities" Within the Meaning of the Securities Exchange Act of 1934 Since They Possess the Material Characteristics of a "Stock", "Certificate of Interest in a Profit-Sharing Agreement", "Transferable Share" and "Investment Contract".

The federal securities legislation is to be construed "not technically and restrictively, but rather flexibly to effectuate its remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 195 (1963). Particularly, the definition of a security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U. S. 293, 299 (1946).

The entire capital of CSA, an Illinois corporation operating as a mutual savings and loan association, is "represented by withdrawable capital accounts (shares and share

10. The dissenting opinion of Judge Cummings in the Court below in itself constitutes a complete and impeccable argument in support of petitioners' contentions and effectively refutes and rebuts each point made in the majority opinion below. This Court's attention in this connection is respectfully directed to the authorities relied on by Judge Cummings and his reasoning in connection therewith.

accounts)".[11] As heretofore shown in the Statement, the Illinois Act provides, among other things, that such shares are transferable (§§ 761, 768) and shall be evidenced by certificates (§ 768); that the shareholders participate in net profits through dividends, when and only if earned, and only if declared by the directors (§§ 762, 778, 780); that shareholders may attend annual meetings (§ 743), vote for directors (§§ 742, 744), pass on organic changes, such as amendments of the articles of incorporation (§ 812), mergers (§ 816), sales of all or substantially all assets (§ 821), reorangizations (§ 872) and voluntary liquidations (§ 902); and upon dissolution or liquidation the shareholders are to receive their respective pro-rata shares of the property of the association after payment of its debts (§§ 908, 926).

Thus by virtue of express terms in the 1934 Act definition, a withdrawable share or share account, created and so endowed under the Illinois Act, is "stock" and a "transferable share"; the certificate which is required to be delivered to the shareholder is a "certificate of interest or participation in any profit-sharing agreement" and the contract entered into between the association and each investor is an "investment contract", all within the meaning of the definition of "security" in Section 3(a)(10) of the Securities Exchange Act of 1934 (hereinafter "the 1934 Act").

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11. § 761(a). These interests are identified variously and interchangeably by the Illinois statute which created them as shares, share accounts, withdrawable capital accounts, matured shares, share interests, share accounts, withdrawable capital, accounts, withdrawable shares, capital, capital accounts, withdrawable share accounts, and holdings of "shareholders". Ill. Rev. Stats., C. 32, §§ 701-944. Such use of these terms interchangeably is entirely consistent. All of them derive from § 761(a) which identifies the "capital of an association" (aside from permanent reserve shares which are not pertinent here) as "withdrawable capital accounts", and identifies those as synonymous with "shares and share accounts."

In construing the substantially similar definition of a security under the Securities Act of 1933 (15 U. S. C. § 77b (1)) (hereinafter "the 1933 Act"),[12] in *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corporation*, 320 U. S. 344 (1943), this Court described the terms "transferable share" and "investment contract", as well as the clause "in general any interest or instrument commonly known as a security", as being of "variable character" and said at 351:

> "We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts', or as 'any interest or instrument commonly known as a security'."

That the interest involved here is a "transferable share" of an interest in the assets of CSA is immediately self-

12. The majority opinion summarily rejects petitioners' citation of cases interpreting "security" in the substantially identical definition in the Securities Act of 1933 (R. 49, 50), on the theory that the term "evidence of indebtedness" found there was omitted from the 1934 Act definition. This is irrelevant because the interests before this Court are not evidences of indebtedness since, as hereinafter shown in the Argument, they do not involve a debtor-creditor relationship. Further, nothing in the Congressional hearings on the 1933 or 1934 Act or elsewhere supports the conclusion that evidences of indebtedness, other than long term notes, bonds and debentures, were intended to be excluded from the 1934 Act definition of "security". Its only expressed exclusion was certain short term commercial paper described as those notes, drafts and bills of exchange with a maturity not exceeding nine months. Even such items with a longer maturity would not be excluded.

evident: "All shares and capital accounts shall be personal property in the hands of their holders, transferable as provided in this Act. . . ." (§ 761(b) and § 768(b)).

The characteristics of this interest also clearly stamp it as "stock". The Illinois Supreme Court, in *Bowman* v. *Armour & Co.*, 17 Ill. 2d 43, at 51, 160 N. E. 2d 753, 757 (1959) defined a share of stock as follows:

> "A share of stock in a corporation is a unit of interest in the corporation and it entitles the shareholder to an aliquot part of the property or its proceeds to the extent indicated. The interest of a shareholder entitles him to participate in the net profits in proportion to the number of his shares, to have a voice in the selection of the corporate officers and, upon dissolution or liquidation, to receive his portion of the property of the corporation that may remain after payment of its debts."

The capital shares of petitioners possess each of these characteristics set out by the Illinois Supreme Court. In *Gidwitz* v. *Lanzit Corrugated Box Company*, 20 Ill. 2d 208, 215; 170 N. E. 2d 131, 135 (1960), the Illinois Supreme Court was even more specific:

> "The essential attribute of a shareholder in a corporation is that he is entitled to participate, according to the amount of his stock in the selection of management of the corporation, and he cannot be deprived or deprive himself of that power."

Under §§ 742, 744 and 746, a shareholder in a savings and loan association is entitled to participate in the selection of management, in proportion to his interest in the association.[13]

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13. Illinois courts have consistently considered the holder of this type of interest to be a "stockholder" and "shareholder". *People* v. *Logan County Building & Loan Association*, 369 Ill. 518 (1938) at 528: "The insolvency of a building and loan association is recognized as *sui generis*. It may be described as a condition which reduces the available and collectible assets below the level

The withdrawable capital shares here also constitute an "investment contract", which was defined in *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), where this Court stated at pages 298-99:

> "... an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise."

The shareholders in this savings and loan association have provided all of its capital (§ 761(a)), are the only persons entitled to share in its profits (§§ 762, 778) and may have surrendered even residual annual control of their common investment by execution of long term proxies which the majority opinion incorrectly described as irrevocable proxies (R. 47). In Illinois, irrevocable proxies are void as against public policy. *Luthy* v. *Ream*, 270 Ill. 170 (1915); *Laughlin* v. *Johnson*, 230 Ill. App. 25 (1923). A proxy form employed by the management of CSA recites that "unless revoked" the proxy is to operate while shareholder continues as such, and "if revoked" revocation applies only to meeting for or at which "right to revoke" is exercised (R. 35).

As heretofore seen, purchasers of these shares are referred to as "holders" (§ 773), the shares are required by statute to be "evidenced by one or more ... certificates"

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of the stock already paid in, thereby rendering it impossible for the association to pay back its stockholders the amount of their contributions." *Marshall Savings and Loan Association* v. *Henson*, 78 Ill. App. 2d 14, 222 N. E. 2d 255 (1966) at 261: "It is undisputed that the Illinois Savings and Loan Act gives the depositors the status of shareholders by conferring one vote for each $100 on deposit and that under this formula the depositors own the majority of the voting rights."

(§ 768(a)), and are transferable by assignment (§ 768(b)). The capital derived by the association through sales of its shares, is invested by the management of the association at the risk of investors, so that if management fails to produce a profit the investors suffer the loss (§§ 778, 780, 781).

CSA, like other similar associations, vigorously solicited the entire public to invest savings in its capital shares[14] and then reinvested the resulting and often small individual investments in, *inter alia,* real estate mortgages, municipal securities and other "marketable investment securities" (§§ 791, 792). CSA's investments were selected and made by decision solely of CSA's board of directors and officers. If those investments turned out to be unwise or unsound, petitioners and other CSA capital shareholders stood to lose their investments—in many cases, the savings of a lifetime. (As to how CSA invested its shareholders' capital and the consequences to them, see footnote 9, p. 10, *supra.*) The investment risk was theirs alone, a critical factor, as observed by Mr. Justice Brennan in *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company,* 359 U. S. 65, 77-80 (1959).

The lower Court was persuaded to find the shares in this savings and loan association not to be securities because, among other reasons: (1) the investor "lends his money to be withdrawable at will and to earn interest" (R. 48), (2) "the relationship with the enterprise is much more that of debtor-creditor than investment" (R. 48) and, (3) like mutual insurance companies "the local state authorities are ready and willing to handle the orderly disposition of the institution's liquidation" (R. 51). The first two statements of the Court below are in error and are unsupported by any authority, nor could they be in the face of the ex-

14. See Exhibits B, C and D to Supplementary Affidavit of George L. Weisbard printed in summary in the Record (R. 38-40). The Exhibits have not been printed.

press provisions of the Illinois Act. Those statements indicate that the Court below failed to comprehend or analyze the true nature of the transactions here involved and developed a confused approach to them. Thus, in one place that Court speaks of such transactions as loans (R. 48) and in another as "deposits" (R. 44, 45). There are, of course, material distinctions between loans and deposits. *Gorham* v. *Hodge*, 6 Ill. 2d 31, 38, 39 (1955). In any event, the transactions here could be neither loans nor deposits under the Illinois Act for several reasons.

In the first place, the investor does not *lend* his money to be withdrawable at will and to earn interest. The transactions permitted by the Illinois Statute are completely different from loans because: (a) the investor has a right to a voice in management, (b) he bears the primary risk of the business venture and could conceivably lose all or part of his investment, (c) no interest is paid, (d) he stands to profit only by way of dividends if earned by the venture and if declared, and (e) there is no obligation on the part of the association to seek him out and pay him until his shares, under certain plans permitted by the Act, have reached, if ever, an agreed maturity value by reason of installment payments and the accretion of dividends.

Secondly, the transactions cannot be viewed as deposits giving rise to debtor-creditor relationships. The Supreme Court of Illinois has so held. *Gorham* v. *Hodge*, 6 Ill. 2d 31, 41 (1955). In addition, the Illinois Act provides that "No association to which this Act applies shall accept or carry any demand, commercial or checking account." (§ 709(a)), and that "the holder of withdrawable capital for which application for withdrawal has been made *does not become a creditor*" (§ 773(f)). (Emphasis supplied.) Obviously, if even application for withdrawal does

not cause him to "become a creditor", the Illinois Act intended that the holder of withdrawable capital not be a creditor.

Much of the reasoning of the court below in the above connection seems to be based on its view that the capital shares of savings and loan associations are withdrawable at will. In the case at bar, the Complaint specifically alleges that CSA's shares purchased by petitioners were not so withdrawable[15] but even that fact is immaterial since withdrawability has a unique meaning in the context of savings and loan associations[16] and in any event does not affect the quality of a "security".[17] Subsequent to the lower court decision in this case, this Court decided *Securities and Exchange Commission* v. *United Benefit Life Insurance Company*, 18 L. ed. 2d 673 (1967), wherein it held a "Flexible Fund Annuity" to be a security despite or because of the fact that "the purchaser, at all times before maturity, is entitled to his proportionate share of the total fund and may withdraw all or part of this interest." 18 L. ed. 2d 676.

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15. The capital shares purchased by the petitioners in this case were sold on a restricted withdrawal basis, as alleged in paragraph 21 of the Complaint (R. 10-11), which allegation must be treated as true at this stage of these proceedings. *Radovich* v. *National Football League*, 352 U. S. 445, 448 (1957); *Guessefeldt* v. *McGrath*, 342 U. S. 308, 310 (1952); *United States* v. *New Wrinkle*, 342 U. S. 371, 376 (1952); and *Collins* v. *Hardyman*, 341 U. S. 651, 652 (1951).

16. "The right of a shareholder to surrender his shares and receive the withdrawal value thereof is a peculiar feature of associations of this character. . . . Withdrawal of stock is but the mode of apportioning to a withdrawing member his share of the assets of the corporation before his stock has reached maturity value . . ." *Young* v. *Stevenson*, 180 Ill. 608, 613 (1899). See also, 13 Am. Jur. 2d, *Building and Loan Associations*, § 30, at pages 170-1.

17. In some cases a similar right of withdrawal has been agreed upon with regard to corporate stock and held to be enforceable where the rights of creditors would not be prejudiced. *In re Tichenor-Grand Co.*, 203 F. 720 (S. D. N. Y. 1913), citing *Ophir Consolidated Mines* v. *Brynteson*, 143 F. 829 (7th Cir. 1906).

The refusal of the Court below to consider the vital characteristics above described which bring the interests here involved within a number of the categories of securities defined in the 1934 Act and its preoccupation with other characteristics which are either misunderstood, misstated or immaterial to the question has led it, as above shown, into serious error and conflict with decisions of this Court. That error, unfortunately, is compounded by the attempt of the Court below to analogize ordinary mutual insurance policies with the interests here under scrutiny. In so doing, it reasoned that these interests are not securities because they may be compared to ordinary insurance policies which are not securities because they are not traded like stock and are State regulated so as to protect policyholders from wrongdoing (R. 50, 51).

That reasoning is fallacious on a number of counts. Firstly, even if the interests here were at all comparable to insurance policies, *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Co.* (VALIC), 359 U. S. 65 (1959) and *Securities and Exchange Commission* v. *United Benefit Life Insurance Company,* 18 L. ed. 2d 673 (1967), do not permit the analogy. Those decisions make clear that when insurance contracts involve considerations of investment and characteristics not present in ordinary insurance policies, *i.e.*, the placing of the investment risk on the policyholder, they are securities within the definition of the 1933 Act. Such characteristics are, of course, the *sine qua non* of petitioners' interests here. Secondly, both of these cases, as well as many others, indicate that it is elementary that trading as a stock is immaterial to whether or not a particular interest is a security under both the 1933 and 1934 Acts. Finally, the reference by the Court below to the alleged fact that the Illinois State authorities are ready, willing and able to handle the orderly disposition of CSA's liquidation (R. 51), as if such readi-

ness could prevent wrongdoing, is aimless and involves a *non sequitur*. The Court below does not state how under the Illinois Act supervision under a voluntary plan of liquidation (or even under an involuntary liquidation) could possibly protect investors from the fraud which induced their purchases of share interests in CSA years before. As a matter of fact, there is nothing in the Illinois Act which affords protection to investors in savings and loan associations after they have been fleeced.[18]

The question of concurrent state regulation is not in this case at all. Even if it were, such regulation is immaterial as is made evident by this Court in *United Benefit Life Insurance Company*, wherein it quotes a Court of Appeal's analysis of the earlier case of *VALIC* with approval as follows at 18 L. ed. 2d 673, 679:

> "The argument 'that the existence of adequate state regulation was the basis for the exemption (the position taken by four dissenting Justices) . . . was conclusively rejected . . . in VALIC for the reason that variable annuities are "securities" and involve considerations of investment not present in the conventional contract of insurance.' *Prudential Insurance Co.* v. *S. E. C.*, 3 Cir., 326 F. 2d 383, 388."

Mr. Justice Brennan in his concurring opinion in *VALIC* (joined by Mr. Justice Stewart) said at 359 U. S. 65, 75:

> "Concurrent regulation . . . was contemplated by the Acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials . . . would be for that reason so perfectly conducted and regulated that all the protections of

18. In the case at bar, it either took the Illinois authorities a number of years to discover that most of CSA's capital had been invested in mortgage loans on properties, the appraisal values of which had been grossly overstated, or else they just condoned such false valuations.

> the Federal Acts would be unnecessary. This approach of personally selected deference to the state administrators is hardly to be attributed to Congress."

In conclusion on this section of the argument, it is pointed out that the oil leases in *Joiner*, the citrus grove units in *Howey*, the variable annuities in *Variable Annuity*, the flexible annuities in *United Benefit* have been held by this Court to be "securities," and interests in fishing boats, automobile trailers, vending machines, parking meters, cemetery lots, tung trees, vineyards, fig orchards, farm lands and patent rights have been held to be "securities" in decisions of lower federal courts. See *e.g.*, 1 Loss, Securities Regulation (2 ed. 1961), pp. 490-91 and 1962 Supplement p. 30 (App. 34). So here, the attributes of petitioners' capital shares in CSA established their character in commerce as securities subject to the 1934 Act.

The primary aim and purpose of both the 1933 and the 1934 Act is the protection of the general public and investors, including uninformed, gullible, ignorant and little investors. *Surowitz* v. *Hilton Hotels Corporation*, 383 U. S. 363 (1966). Judge Cummings set forth how the aims and purposes of the 1934 Act are served by the application of that Act "to the typical savings and loan account-holder (who) is a small investor, as unwary and in need of protection as a typical, unsophisticated holder of corporate stock" (R. 63).

II.

Withdrawable Capital Shares in a Savings and Loan Association Are "Instruments Commonly Known as a 'Security'" and Are Therefore Within the Ambit of the Securities Exchange Act of 1934.

It has been demonstrated hereinabove that under the Illinois Act the substance of the investment relationship involved in the interests here under consideration is not that of an evidence of indebtedness because no debtor-creditor relationship existed; that in keeping with the ruling of the Illinois Supreme Court in *Gorham* v. *Hodge,* 6 Ill. 2d 31, 41, a savings and loan association chartered and operating under the Illinois Act could not have accepted such investments under a debtor-creditor relationship; and that the lower Court erred in rejecting out of hand from consideration here the decisions of this Court interpreting "security" under the definition in the Securities Act of 1933 (R. 52), for the declared but erroneous as well as irrelevant reason that the investors here loaned their money at interest and their investments were therefore "evidences of indebtedness" (R. 48-50).

It has been further demonstrated hereinabove that the investment interests here under consideration fall within at least four of the categories of the 1934 Act definition, *i.e.*, "stock", "transferable share", "investment contract", and "certificate of interest or participation in any profit sharing agreement". It is demonstrable, contrary to the lower Court's opinion, that these interests also fall within the catch-all clause of the definition, "or in general any instrument commonly known as a 'security'".

To what sources are we to look in ascertaining whether the interests here are "commonly known as a 'security'"? The lower Court points to the Congressional hearings on

the 1933 Act (R. 50), the House Report accompanying that Act (R. 47), the preamble to the 1934 Act (R. 47), and to the action of the Illinois legislature in adopting the Illinois Act (R. 47).

In noting that the Illinois Act (§ 768(c)) provides that these certificates and account books shall not be subject to Article 8 of the Uniform Commercial Code, which deals solely with negotiable "securities", the Court below concludes therefrom "that the Illinois legislature did not intend them to be securities", and that "It thus seems difficult to assert that these interests can be 'commonly known as a security.'" (R. 47.) The lower Court fails to recognize that in excluding these interests from applicability of an article of the Commercial Code which deals solely with those *securities* which are to have the attribute of negotiability, the very necessity of the exclusion discloses that the legislature considered these interests to be securities. There is a broad gap between the expressed intention of the legislature that these interests are not to be subject to an Act which deals solely with negotiability and the unwarranted conclusion drawn therefrom by the lower Court that the legislature intended that they not be considered securities for any purpose. The lower Court fails to explain how it bridged that gap. There are a variety of reasons why its conclusion is erroneous.

Most obvious is the fact that § 768(c) provides that these interests shall be "non-negotiable", and it was therefore necessary for the same section to provide that such non-negotiable interests should not be subject to the article of the Commercial Code which deals only with negotiable securities. Had the legislature intended by the language of § 768(c) to exclude these interests from being subject to the Illinois Securities Law of 1953, Ill. Rev. Stat., 1965, ch. 121½, § 137 *et seq.*, it could have done so with the same

specificity as it used in stating their exclusion from Article 8 of the Commercial Code.

The lower Court obviously failed to note the official Illinois Code comment to ch. 26, § 8-102 of the Code, defining "security" for the limited purposes of that Article. This comment specifically recognizes that the definition of security contained in Article 8 of the Code is a narrower definition, for the purposes of that article only, while,

> "Securities are broadly defined in the Illinois Securities Law of 1953, the Securities Act of 1933 and the Securities Exchange Act of 1934 for regulatory purposes." Illinois Code Comment, S. H. A., ch. 26, Section 8-102.

Thus it has been officially recognized that coverage under the regulatory Illinois Securities Law of 1953 is far wider than coverage under Article 8 of the Illinois Commercial Code.

Under that Securities Law the Illinois legislature expressly recognized by designation that the withdrawable capital share and share account are securities and specifically provided an exemption for them, but only from those of its provisions pertaining to registration. That Act states:

> "The provisions of Sections *5 and 7* of this Act shall not apply to any of the following *securities:* . . .
>
> D. *Securities* issued by and representing an interest in or an obligation of, (1) any building and loan association incorporated under the laws of the state, (2) any Federal Savings and Loan Association, (3) any savings and loan association incorporated under the laws of any state if such association is a member or stockholder of the Federal Savings and Loan Insurance Corporation, or (4) any credit union approved and supervised by the Auditor of Public Accounts; . . ." (Ill. Rev. Stat., 1965, ch. 121½, 137.3.) (Emphasis added.)

Such an exemption of savings and loan shares has existed continuously since prior to the time it first became possible in 1953 for an Illinois savings and loan association to issue permanent reserve shares (a type of share other than withdrawable capital shares and not involved here). (Ill. Rev. Stat. 1951, ch. 121½, § 99A (2).)

The Illinois legislature by exempting such withdrawable capital shares and share accounts from registration only, has thereby also indicated its determination that these interests, which it designates as securities, should be subject to all provisions of the Illinois Securities Act other than §§ 5 and 7 thereof, the registration provisions.[19]

The conclusion inevitably follows that these interests are "commonly known" to the Illinois legislature as securities both by designation and by essential substance, otherwise there would have been no necessity for the legislature to exclude them from the negotiability section of the Commercial Code and from the registration provisions of the Illinois Securities Act of 1953. But this conclusion that the legislature regards these interests as "securities" does

19. The existence of a concurrent remedy or of concurrent supervision under the Illinois Blue Sky law is not claimed by anyone to render void similar provisions in federal securities laws. As to any question of whether State supervision of operations of savings and loan associations has any bearing on applicability of the anti-fraud provisions of the federal securities laws to withdrawable shares, it is to be noted that the kind of State supervision or regulation under the Illinois Act does not touch on the area of issuance of shares and share accounts. The basic right to issue them is fixed by statute, and the situation is unlike the State regulation of issuance of contracts of insurance, which must be approved as to each form of contract by a State Administrative Agency. Ill. Rev. Stat. 1965, ch. 73, § 755. As to savings and loan associations, State regulation under the Illinois Act has nothing to do with the kind of problems involved in the anti-fraud provisions of the 1934 Act and no comparable power is given to State officials under the Illinois Act to control the issuance by an association in good financial standing of shares or share accounts if the plan of issuance is one of those authorized by the Illinois Act.

not rest merely on the foregoing explanation of the legislative attitude toward these interests demonstrated by enactment of § 768(c) of the Illinois Act and by enactment of § 137.3 of the Illinois Securities Act, or on the foregoing explanation of the error committed by the lower Court's unwarranted extension of what is merely a limited and narrow exemption of these interests from the negotiability article of the Commercial Code. The lower Court also overlooked the action of the Illinois legislature in adopting other laws which designate these interests as "securities".

The Investment of Public Funds Act, Ill. Rev. Stat., 1965, ch. 102, § 30, permits any public agency to "invest any public funds in . . . shares or other forms of *securities* legally issuable by savings and loan associations incorporated under the laws of this State or any other state, or under the laws of the United States . . .". (Emphasis added.) This Act was adopted in 1943 at a time when the capital of an Illinois savings and loan association could consist only of the withdrawable type of interest under consideration here.

The State Treasurer Act, Ill. Rev. Stat., 1965, ch. 130, § 41a, permits the investment of State money,

> "in shares and investment certificates of savings and building and loan associations, incorporated under the laws of this State or any other state or under the laws of the United States . . .".

and provides that such investments may be made only in those associations whose "shares *or other forms of investment securities*" are federally insured. (Emphasis added.)

The Credit Union Act of Illinois, Ill. Rev. Stat., 1965, ch. 32, § 496.23, provides that a credit union "may invest its funds in any of the following designated *securities*:" (Emphasis added.)

> "(2) shares or investment certificates of any savings

. . . and loan association incorporated under the laws of this State or of any other state or of the United States . . .".

Further, the interpretation of the words "commonly known as a security" is not restricted to those investments which may specifically be called "security". A reasonable interpretation necessarily looks to the substance or essential nature of the investment relationship involved. Those investments which by this measure are the substantial equivalent of a "security" must be included under the "commonly known as a security" portion of the definition. The Statement, *supra,* pp. 4-11 includes in ample detail references to sections of the Illinois Act creating the investment relationships involved in the interests here under consideration. The sections there cited establish that these interests are securities within the meaning of the 1934 Act definition.

The Illinois legislature has enacted other Acts by which the shares or accounts of savings and loan associations are declared to be authorized investments. In adopting those Acts, the Illinois legislature was dealing with instruments involving the substance of the type of investment relationships "commonly known as a security", within the meaning of *SEC* v. *C. M. Joiner Leasing Corporation,* 320 U. S. 344, 351. There it was held that instruments may be included within any of the categories in the 1933 Act definition "as matter of law, if on their face they answer to the name or description . . .". *Joiner* further held, p. 351, "However . . . irregular devices, whatever they appear to be, are also reached [by the definition] if . . . widely offered or dealt in under terms or courses of dealing which established their character in commerce . . . as 'any interest or instrument commonly known as a security'."

The Illinois Insurance Code, Ill. Rev. Stat., 1965, ch. 73,

§ 737.14a, authorizes any domestic insurance company to invest in shares or accounts of savings and loan associations of a withdrawable type, but it may not so invest more than 20% of its admitted assets or more than 2% thereof in any one such association.

Under § 792.1 of the Illinois Act an Illinois savings and loan association may invest part of its available excess funds in withdrawable capital of any other state or federal association which is federally insured.

§ 953 of the Illinois Act provides that any Illinois chartered or federal savings and loan association may issue its shares, share accounts or accounts in the name of any administrator, executor, guardian, trustee or other fiduciary, in trust.

The Illinois Probate Act, Ill. Rev. Stat., 1965, ch. 3, § 259(e) permits guardians or conservators, with approval of Court, to invest in shares of state chartered building and loan associations and in shares of federally chartered savings and loan associations, if federally insured.

An equally fruitful source overlooked by the lower Court in determining whether these interests are commonly known as a security, is the savings and loan industry itself. The report of a study by members of the legal staff of the United States Savings and Loan League published in its Legal Bulletin, Vol. XXVIII, No. 4, July 1962 (pp. 129-234), is highly illuminating. It demonstrates that savings and loan shares and share accounts are "authorized investments" in virtually all states, the District of Columbia and under federal law, and that many times these interests have been referred to in legislation as "securities." The study includes a report on Illinois law and cites various references in Illinois statutes to these interests as "securities".

After extolling the safety and investment advantages of

savings and loan accounts, due to sound, informed and experienced management, with a consistently high return on the investments by the shareholders, the report states at page 136:

> "It is a fact that savings and loan accounts are categorized more appropriately as 'legal list' investments than as investments authorized by the 'prudent man' rule in *more variable securities* (such as the shares of sound business corporations). Since the 'legal list' investments are a more limited group the inclusion of savings association accounts in these lists makes automatic their inclusion among those investments available to the prudent man." (Emphasis added.)

Such comparison of savings and loan accounts with "more variable securities" implies that the legal staff of the USSL consider savings and loan accounts as securities.

This conclusion as to the official position of the USSL is supported by the Congressional hearings on the adoption of the Securities Act of 1933. The record discloses that the president of that national organization and its general counsel, as spokesmen for the savings and loan industry, emphatically supported the application of the anti-fraud provisions of that Act to savings and loan shares, even though opposing registration of such interests. (Hearings on H. R. 4314 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., First Sess., pp. 72-74 (1933); Hearings on H. R. 7620 before House Subcommittee of Committee on Banking and Currency, 72nd Cong., First Sess., p. 144 (1932); and Hearings on S. 875 before Senate Committee on Banking and Currency, 73rd Cong., First Sess., pp. 50-54, 98-102, 111-114 (1933).)

The reason urged by these spokesmen in favor of exempting savings and loan shares from the registration provisions of that Act was solely the expense which would be involved. (Hearing on H. R. 4314 before the House Com-

mittee on Interstate and Foreign Commerce, 73rd Cong., First Sess., pp. 70-80 (1933).)

In addition, one of the draftsmen of the 1933 Act, Walter L. Miller, Chief of the Foreign Service Division, Bureau of Foreign and Domestic Commerce, testified that the drafting committee had given careful consideration to coverage of savings and loan shares, including withdrawable capital accounts, and had concluded that the danger of fraudulent practice and promotions by some members of the industry warranted the inclusion of these savings and loan association interests, not only within the anti-fraud provisions of the 1933 Act, but within the registration provisions as well. Indeed, the thrust of Mr. Miller's testimony was that in order adequately to protect investors by means of the 1933 Act, it would be necessary to require registration of savings and loan association interests. (Hearings on H. R. 4314 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., First Sess., p. 74 (1933).)

When the Securities Law of 1933 was enacted, the Secretary of the United States Building and Loan League advised its member associations that they were "subject to the fraud provisions" of that Act, something which would only have been true if he and the League understood shares in such associations to be "securities". See Building and Loan Annals (1933), pp. 564-65. See also Richards, *The Federal Securities Act,* Building and Loan Annals (1933), pp. 111, 115-118.

It is a significant parallel in the federal Securities Act of 1933 and the Illinois Securities Law of 1953 that these interests are exempt only from the registration provisions, leaving them subject to the anti-fraud provisions of both Acts. There is a further parallel in what happened in the adoption of the 1934 Act and the 1964 amendments thereto. When adopted in 1934 that Act contained no registration

provisions and no exemption of the interests here from its anti-fraud provisions. When registration provisions were added by the 1964 amendments, specific exemption of savings and loan association shares was provided from such new registration provisions, but only therefrom. The newly created exemption did not exempt them from the 1934 Act's long standing anti-fraud provisions.

Section 12(g)(2)(c) of the 1934 Act amendments (adopted in 1964), provides:

> "(2) The provisions of this subsection shall not apply in respect to . . .
>
> (c) any security other than permanent stock, guarantee stock, permanent reserve stock or any similar certificate evidencing non-withdrawable capital, issued by a savings and loan association, . . . which is supervised and examined by State or Federal authority having supervision over any such institution." 15 U. S. C. § 78*l*(g)(2)(c).

This reference is enlightening because Congress in the foregoing exemption of withdrawable shares of savings and loan associations specified that instruments representing non-withdrawable capital should not be exempt from these new registration provisions added to the 1934 Act. The new exemption thus covered "any *security* other than . . . non-withdrawable capital issued by a savings and loan association," and included the withdrawable capital shares and share accounts issued by CSA within the exemption from registration.

The suggestion by the lower Court (R. 49, 50), that the inclusion of the exemption from registration was unnecessary because these interests are not commonly regarded as a security and do not otherwise qualify as such, simply cannot be supported. The same Congress which wrote the Securities Act of 1933 wrote the 1934 Act. If an excess of caution was exercised by Congress in 1933, as suggested

in the majority opinion below, why would not the same Congress have done likewise in 1934.

It is also to be noted, as pointed out by Judge Cummings in his dissenting opinion, that the Securities and Exchange Commission has interpreted the Act as requiring registration of brokers who specialize in the sale of savings and loan shares (R. 62). In its Brief in support of the Petition for Certiorari here the Commission noted that in 1934 a temporary exemption was granted by it for trading in savings and loan passbooks on the Cleveland stock exchange (p. 9). Further in the case of *Archer et al.* v. *S. E. C.*, 133 F. 2d 795 (8 Cir. 1943), discussed at pages 12 and 13 of Petitioners' Reply to Briefs in Opposition to the Petition for Writ of Certiorari, the decision, at p. 801, discloses that certain certificates issued by a savings and loan association were there involved in misconduct by brokers in violation of the 1934 Act, and in violation of a rule thereunder. The decision indicates that the certificates were traded over-the-counter and that the price fluctuated widely, was manipulated, and that the improprieties constituted a violation of a section of the 1934 Act involving a "security". The source of information that the precise investment interests there involved were withdrawable capital is stated in footnote 17 at page 13 of that Reply Brief.

The reference in the lower Court's opinion to the Congressional Hearings as support for the statement that some Senators evidently saw a relationship between these interests and evidences of indebtedness is simply not supportable by anything in the record of those hearings on the 1933 Act. Further there is nothing in the House Report, or in the preamble to the 1934 Act, referred to at R. 47, which in any way supports the findings of the lower Court that these interests were not then commonly known as securities or that there was ever any intention that savings

and loan shares and share accounts be excluded from the anti-fraud provisions of either the 1933 or 1934 Act. The inclusion in the preamble of reference to immediate events which precipitated passage of the 1934 Act cannot be construed as a limitation on the clear and precise language of the 1934 Act definition, which includes the investment interests involved here within at least five of the designated categories of "security" in that definition.

The majority opinion below makes scant reference to the Congressional hearings on the 1934 Act, apparently being satisfied that there was no discussion of savings and loan interests at that time (R. 50). Although at the same page the Court comments on the "evidence of indebtedness" aspect of the hearings on the 1933 Act, and further cites the Report accompanying that Act (R. 47), no reference is made in that opinion to the Report of the Senate Committee on Banking and Currency as to the 1934 Act. In order to understand the purposes of that Act, it is necessary to note that the Report in its Introductory Statement contains three numbered sets of reasons for its enactment. At the conclusion of that Statement appears the following:

> "The three principal problems with which the bill deals are the excessive use of credit for speculation, the unfair practices employed in speculation, and the secrecy surrounding the financial condition of corporations which invite the public to purchase their securities." (Report of Senate Committee on Banking and Currency, 73rd Cong., 2d Sess., No. 792, April 17, 1934, to accompany S. 3420, entitled Federal Securities Exchange Act of 1934, p. 5.)

On policy there appears to be no reason to believe that Congress considered investors in savings and loan shares and accounts to be less needy of the protections against fraud accomplished through non-disclosure and secrecy, than are small investors in other types of securities which the lower

Court would concede to be included within the scope of the Act.

The overriding consideration apparently governing the majority opinion below is the notion that the definition of "security" in the 1934 Act is to be restrictively interpreted. This, of course, is contrary to the rule that remedial statutes are to be liberally interpreted to accomplish their beneficial purposes.

The majority opinion thus devotes its major attention to finding similarities to irrelevant situations and such dissimilarities as it can between the interests here involved and that Court's own idea of the formal or mechanical aspects of a security. As to such of these aspects as it did consider, its conclusions are largely erroneous. But even were it valid to decide the case by reference to mere matters of form rather than substance, the lower Court could not properly ignore, as it did here, the great preponderance of attributes of a security found in these interests, while listing every strained and fancied dissimilarity suggested by respondents.

CONCLUSION.

Petitioners urge that the judgment of the Court of Appeals be reversed.

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